SERVAL

INTEGRATED ENERGY SERVICES

ANNUAL REPORT 1998

SERVAL
INTEGRATED ENERGY SERVICES

Serval Integrated Energy Services supplies high quality, cost-effective products and services to Western Canadian oil and gas producers.

Serval "units" are listed for trading or the Alberta Stock Exchange under the symbol SI.UN.

Serval provides a wide range of integrated services through four major divisions operating from service centres in five Western Canadian cities.

Coiled Tubing

- Coiled Tubing Drilling
- Cementing
- Conventional Coiled Tubing Services
- Stimulation

Manufactured Products

- Compression Equipment
- Process Equipment
- Water Treatment

Waste Management

- Waste Collection & Handling
- Fluid Management
- Solids Control

Construction

- Plowed-In Small Diameter Pipelines

President's Message to Unitholders

In 1998 Serval Integrated Energy Services experienced difficult times and recorded substantial losses. Since that time, Serval has restructured to respond to a radically changed marketplace and refocus its going forward activities on substantially higher margin business opportunities.

For the eight months ended December 31, 1998, Serval reported a net loss of $28.2 million. In its prior fiscal year ended April 30, 1998, Serval's net earnings were $2.8 million. Revenues from continuing operations in the eight months ended December 31, 1998 amounted to $57.2 million. In the 12 months ended April 30, 1998, Serval's revenues from continuing operations amounted to $148.9 million. At December 31, 1998, Serval had total assets of $98.1 million, unitholders' equity of $26.5 million and long term debt of $1.7 million.

The recent restructuring to position Serval for profitability in today's more challenging oil and gas service sector is now virtually complete. Lower margin business units have been sold or shut down, overhead has been slashed, and underutilized property and equipment sold.

Serval's current goal is to deliver on two commitments. The first is the need to provide a solid return on investment to unitholders. The second is to provide integrated energy services that help oil and gas producers to drive down their exploration, development and operating costs.

We are confident that the changes we have made within Serval over the past five months will allow us to accomplish both of these objectives. As we rebuild a solid, profitable foundation within Serval Integrated Energy Services, we intend to focus on a "smaller" and "simpler" approach. This will allow us to continue to reduce customer costs and deliver higher margins that will contribute to Serval's bottom line.

The higher margin opportunities that Serval will pursue over the next year include coiled tubing drilling and other coiled tubing services where there is reduced competition and greater margins. Serval also remains committed to the delivery of specialized manufacturing and construction services where we can expect greater profitability. We have discontinued capital intensive business units with more uncertain profitability. Serval has also exited from business activities that require high levels of inventory for effective participation.

These are extremely challenging times to be participating in the oil and gas services sector. However, we believe that we have made the tough decisions that have refined our organization and will allow us to not only survive but to rebuild in 1999 and beyond.

We appreciate the support of our unitholders, our employees, our suppliers and financial organizations with whom we have worked during these difficult times. The worst is now behind us and we look forward to a brighter and more profitable future.

Jay C. Lyons
President and Chief Executive Officer

Calgary, Alberta
May 20, 1999

Management's Discussion & Analysis

The following discussion and analysis of the results of operations and financial condition should be read in conjunction with the consolidated financial statements and accompanying notes contained in this annual report.

This discussion includes "forward-looking" statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of Serval Integrated Energy Services ("Serval"), or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following:

General economic and business conditions, which will affect demand for Serval's services and products; industry capacity; the ability of Serval to implement its business strategy; changes in, or the failure to comply with government regulations (especially health, safety and environmental laws, regulations and guidelines).

General

Serval Integrated Energy Services ("Serval") is an unincorporated trust established on February 28, 1997, pursuant to the laws of the Province of Alberta. Serval refers to its equity as "units" and to its investors as "unitholders". There are 4,778,160 units outstanding. References made herein to per unit statistics are based on the weighted average number of units outstanding during the eight month period ended December 31, 1998 of 4,779,255 Units (April 30, 1998 - 4,583,377) for basic calculations; and 5,157,255 Units (April 30, 1998 - 4,904,377) for fully diluted calculations, except where the use of this latter statistic in the current period would reduce the negative amount calculated using the basic denominator.

On December 31, 1998, Serval changed its fiscal year end from April 30 to December 31 to be consistent with the majority of its industry participants.

As discussed below, there were a number of asset sales and some business units were discontinued, both before and after December 31, 1998. Serval's core business units going forward consist of the following:

1) Coiled Tubing ("CT")

- Drilling (fleet presently consists of one CT drilling rig; two additional units are under construction). Drilling is currently in a "start-up" phase with testing and modifications substantially completed;
- Cementing (one cementing unit supported by bulk plant; four cement bulkers and satellite equipment);
- Service (fleet consists of three CT service rigs);
- Stimulation (two Acid/Nitrogen pumper units).

2) Manufactured Products

- Production equipment;
- Fabrication of compressor packages;
- Water treatment equipment.

3) Waste Management

- Fluids management – fleet of 14 vacuum trucks, pumps, tanks, wellsite trailers and support equipment;
- Solids control – fleet of 44 centrifuges, pumps, tanks and support equipment;
- Waste collection; handling and sorting of regulated waste using EnviroSORT waste handling systems utilizing licensed regulated waste handling location in Red Deer, Alberta.

4) Construction

- Grande Prairie-based construction services with capacity to plow 2" , 3", and 4" pipelines at up to eight feet of cover. Management believes that more pipelining will be done in the future using coil tubing to reduce labour and installation costs.

Serval supports its ongoing operations from owned regional service centres located in Calgary, Edmonton, Red Deer, Grande Prairie and Medicine Hat, Alberta.

Industry Activity Indicators

Serval operates primarily in the oil and gas service sector. Demand for Serval's products and services depends heavily upon the level of drilling activity and associated exploration and development expenditures by oil and gas producers. Expenditures are influenced by the availability of capital to the oil and gas production companies and are affected by commodity prices for oil and gas; the capacity to deliver to markets; and the degree of investor confidence in the sector. This is also influenced by global capital markets, credit conditions and other economic factors.

The following statistics illustrate the reduced activity levels the Canadian oil and gas service sector has experienced in the past year:

	1998	1997
Number of wells drilled	9,744	16,484
Metres of hole drilled – millions	12.1	18.3
Number of oil well completions	3,142	8,553
Rig utilization – January 1 to December 31	51%	84%
Rig utilization – May 1 to December 31	40%	85%
Average Prices:		
Oil – West Texas Intermediate ($U.S. per barrel)	$ 14.38	$ 20.66
Oil – Edmonton Sweet Light ($Cdn per barrel)	$ 20.35	$ 27.58
Natural Gas – Alberta Border Price ($Cdn per mcf)	$ 2.08	$ 1.87

Results of Operations

In the eight month period ended December 31, 1998, Serval's net loss was $28.2 million (negative $5.90 per Unit). In the year ended April 30, 1998, Serval's net earnings were $2.8 million ($0.61 per Unit, fully diluted). These statistics include a loss from discontinued operations in the reporting periods of $3.1 million (negative $0.66 per Unit) and $7,363, respectively.

In the eight month period ended December 31, 1998, Serval's negative cash outflow to operations was $11.4 million (negative $2.38 per Unit). In the year ended April 30, 1998, Serval's cash flow from operations was $9.5 million ($1.97 per Unit, fully diluted). The cash outflow to discontinued operations in the eight month period ended December 31, 1998 was $1.8 million (negative $0.37 per Unit) compared to cash flow from discontinued operations in the year ended April 30, 1998 of $363,617 ($0.07 per Unit).

Write-downs of goodwill and other assets of $12.3 million and a write-down of inventory of $925,000 are included in the results for the eight month period ended December 31, 1998 as are restructuring expenses of $1.9 million. There are no comparable amounts charged to earnings in the year ended April 30, 1998.

The current period loss also contains a loss on the sale of capital assets of $472,351 compared to a gain on the sale of capital assets included in the results for the year ended April 30, 1998 of $987,414.

Interest expense in the eight months ended December 31, 1998 of $2.24 million is significantly higher than the $786,214 recorded in the year ended April 30, 1998 reflecting an increase in the debt component of Serval's capitalization.

Serval's revenues from continuing operations in the eight month period ended December 31, 1998 of $57.2 million included $5.0 million from the acquisition of Bearspaw Compression Industries Ltd. effective May 1, 1998. Revenues in the eight months ended December 31, 1998 were significantly lower than the revenues from continuing operations for the year ended April 30, 1998 of $148.9 million, even after making a notional adjustment for the different lengths in the reporting periods covered (8 months compared to 12 months).

It is important to note that the revenue statistics above include $29.9 million and $100.7 million in the eight months ended December 31, 1998 and in the year ended April 30, 1998, respectively, for businesses that were discontinued by Serval subsequent to December 31, 1998. The businesses subsequently discontinued were the tubulars distribution business and the Coronation, Alberta-based pipelining business of Serval's construction services.

During the eight month period ended December 31, 1998, there was significantly diminished investor confidence in the oil and gas sector due to international uncertainties in global markets. Demand for oil dropped. Overproduction led to a bulge in oil inventories and drove oil prices lower. Capital did not flow to Serval's customers and credit markets tightened. These factors led to a sharp drop in demand for Serval products and services.

While the impact of lower oil prices is clear, it is not appropriate to allocate all of Serval's reduced financial performance on this circumstance alone. Other factors played a major role. Serval had previously grown quickly; it experienced problems with two of the acquisitions it completed in the year ended April 30, 1998, compounded by changing market conditions; it committed to deliver new coiled tubing technology when it had restrictions on its financial resources and the capital markets did not provide a sufficient injection of new cash. In addition, Serval's infrastructure was built to service a level of demand that existed in 1997, which level of demand did not materialize in 1998. As a result, Serval needed to significantly downsize operations and sell assets.

It remains Management's view that the positioning of Serval to deliver advanced drilling technology, through the coiled tubing platform, will materially benefit Serval's investors in the future. Serval will require its stakeholders' ongoing support to move through this difficult period and rebuild working capital. Recent, post-December 31, 1998 improvements in commodity prices are raising confidence levels in the industry. This development, together with post-December 31, 1998 asset sales, corresponding debt reductions and further overhead reduction, should help restore Serval to profitable operations.

The following is a summary of Serval's revenues by operating segment (see Notes 20 and 21):

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
As reported:		
Waste Management	$ 8,608,809	$ 28,745,210
Manufactured Products	35,083,763	79,563,197
Coiled Tubing	310,245	–
Construction	13,203,170	40,600,135
	$ 57,205,987	$ 148,908,542
ProForma – adjusted to delete businesses discontinued subsequent to December 31, 1998:		
Waste Management	$ 8,608,809	$ 28,745,210
Manufactured Products	18,350,490	19,445,732
Coiled Tubing	310,245	–
Construction	–	–
	$ 27,269,544	$ 48,190,942

The following is a summary of Serval's EBITDA by operating segment (see Notes 20 and 21):

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
As Reported:		
Waste Management	$ (416,770)	$ 4,749,166
Manufactured Products	327,564	3,204,833
Coiled Tubing	(165,354)	–
Construction	(71,126)	6,668,407
Corporate	(4,754,271)	(4,487,011)
	$ (5,079,957)	$ 10,135,395
ProForma – adjusted to delete businesses discontinued subsequent to December 31, 1998:		
Waste Management	$ (416,770)	$ 4,749,166
Manufactured Products	907,146	1,672,893
Coiled Tubing	(165,354)	–
Construction	–	–
Corporate	(4,754,271)	(4,487,011)
	$ (4,429,249)	$ 1,935,048

Serval's consolidated gross margin decreased from 18.7% in the year ended April 30, 1998 to 14.8% in the eight month period ended December 31, 1998. The industry downturn forced additional pricing pressure onto service companies seeking to protect their market share. In addition, Serval's shortage of working capital increased costs from suppliers protecting themselves from extended payment terms. Further, the fixed component of direct costs is not as quickly reduced as disappearing sales in an industry downturn. When the number of wells drilled by the industry slips from 16,484 to 9,744 in the year, it is difficult to maintain margins.

Management believes that Serval's continuing business units are capable of substantially higher margins on a blended average basis, once the coiled tubing initiative begins to contribute positively. The gross margin of the tubulars distribution business, discontinued subsequent to December 31, 1998, was 4.7% in the eight months ended December 31, 1998 as compared to 6.8% in the year ended April 30, 1998. The gross margin of Serval's Coronation-based pipeline construction business unit, discontinued subsequent to December 31, 1998, was 9.1% in the eight months ended December 31, 1998 and 21.5% in the year ended April 30, 1998.

Total general and administrative expenses in the eight months ended December 31, 1998 amounted to $15.1 million including $13.6 million relating to continuing operations and $1.5 million relating to operations discontinued prior to December 31, 1998. Total general and administrative expenses in the year ended April 30, 1998 amounted to $20.6 million including $17.8 million relating to continuing operations and $2.8 million relating to operations discontinued before December 31, 1998. The general and administrative expenses included in the continuing amounts above which relate to businesses discontinued subsequent to December 31, 1998 were $2.9 million for the eight months ended December 31, 1998 and $4.6 million for the year ended April 30, 1998.

Depreciation and amortization expenses were $4.4 million or 7.7% of revenues in the eight months ended December 31, 1998 as compared to $6.3 million or 4.2% of revenues for the year ended April 30, 1998. In dollar terms, these amounts are as expected given the nature of Serval's depreciable assets and the timing of capital expenditures. In percentage-of-revenue terms, the increase in the current period statistic is more a reflection of the sharp drop in revenues and the booking of depreciation expense on a time basis versus a utilization basis.

The significant pre-tax loss in the current period resulted in a recovery of deferred income taxes previously recognized of $2.4 million. Otherwise, Serval is subject to a payment of large corporations tax of approximately $195,000. Serval's tax losses carried forward to future years exceed $18.5 million, before claiming capital cost allowances, which tax shelter is expected to provide benefit in future periods.

Discontinued Operations, Write-Downs and Restructuring Expenses

Effective October 31, 1998, Serval sold its bottled water business for cash proceeds of $3 million and also discontinued its international operations resulting in losses of $0.5 million and $2.6 million respectively. The discontinuances before and after December 31, 1998 were considered in the review of goodwill for permanent impairment; in the consideration of the commercial viability of other assets; and in the determination of estimated realizable value of the carrying value of inventory. These tests and market conditions resulted in the recognition as at December 31, 1998 of a write-down of goodwill of $8.3 million; a write-down of other assets of $3.9 million; and a write-down of inventory of $0.9 million. In addition, Serval incurred restructuring costs of $1.9 million in the period including: costs to convert business units operating under predecessor names to "Serval"; severance costs; professional fees; relocation expenses and accelerated write-offs relating to the change in fiscal year end.

Financial Condition, Liquidity and Capital Resources

At December 31, 1998, Serval was in technical breach of covenants under its loan agreements requiring a minimum working capital ratio (1.1 to 1.0) and a maximum ratio of consolidated debt to tangible net worth (2.0 to 1.0). Subsequent to December 31, 1998, Serval has drawn funds under its operating facility in excess of its margin coverage. Serval's secured term lenders have not demanded repayment of Serval's term debt nor have they waived their right to do so. Accordingly, $16.2 million of term debt that would otherwise be classified as "long-term" has been reclassified as "current" in accordance with generally accepted accounting principles. All payments required under the term debt facilities have been paid when due and these facilities were otherwise in good standing at December 31, 1998.

Serval's continuing operations may be dependent upon its ability to obtain further debt or equity financing; improvement in its operations; the continued support of its lenders; and/or sales of certain assets. It is important to note significant progress has been made in these areas subsequent to December 31, 1998.

Serval's working capital deficiency as at December 31, 1998 of $30.3 million includes the classification of $23.1 million of its term debt as current. Serval's negative cash flow from operations in the eight month period ended December 31, 1998 of $11.4 million, including $1.8 million relating to discontinued operations, contributed to the negative position and placed Serval in a difficult liquidity condition as at December 31, 1998.

To overcome this situation, Management initiated a major rationalization of operations through the disposal of assets, the discontinuance of various Serval businesses and an ongoing program to reduce overhead. Asset sales subsequent to December 31, 1998 and the completion of a Special Notes private placement have provided additional estimated net proceeds of $14.7 million to reduce debt and add to working capital.

Management will continue to seek a re-financing of the remaining capital assets to more appropriately match Serval's long-term productive capacity against term debt and improve Serval's working capital position. At December 31, 1998, only $1.7 million of Serval's term debt was long-term yet Serval's capital assets, before the sales subsequent to year end, amounted to $46.0 million.

Unitholders Equity at December 31, 1998 amounted to $26.5 million.

At December 31, 1998, the credit facilities available to Serval included a bank operating loan to a maximum of $25 million, subject to a borrowing base formula, bearing interest at bank prime rate plus 0.5% or at bankers' acceptances plus a stamping fee of 1.5%. The credit facility is secured by a first priority charge on accounts receivable and inventory and a general security agreement covering all the assets of Serval, on a parri passu basis with Serval's major term lender.

Year 2000 Issue

The "Year 2000 Issue" arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using the year 2000 date is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting Serval, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

Serval could be adversely affected if Year 2000 Issues are not resolved by Serval or other third parties upon whom Serval is dependent. It is reasonable to believe that at least some minor disruptions will occur. Serval has selected a committee of personnel to oversee its exposure and response to the Year 2000 Issue. The responsibility of the committee is to lead and co-ordinate efforts to protect Serval and its stakeholders from the potential impacts of the Year 2000 Issue; and to arrange contingency plans that will mitigate, as best as can possibly be conceived in advance, Serval's exposure to external risks. The committee's approach includes:

(a) the identification and assessment of areas of non-compliance and potential risk, both internal and external; in areas of administration as well as in operations;
(b) the formulation of strategies to remedy potential problems;
(c) the implementation of remedies to mitigate or reduce exposure;
(d) testing and changes, as may be required; and
(e) contingency planning.

The consideration of potential areas of risk is ongoing. Internal testing and the remedy of internal systems is expected to be finalized by July 31, 1999. Systems have been either upgraded, replaced or discarded to ready Serval for the Year 2000 challenge. It is Serval policy to independently test any systems even when they are certified by vendors as being Year 2000 compliant.

Although Serval has communicated its concerns to numerous external parties upon whom it is dependent, there is no assurance that significant Year 2000 related problems attributable to them will not ultimately arise.

Contingency planning relating to Serval's dependence on third parties remains in progress. Such plans will be more specifically developed prior to the end of the century.

The costs of review, testing and repair are expensed as incurred. New hardware, software and upgrades are capitalized if they add to the future value of the system. Serval expects its cost relating to the Year 2000 Issue will be about $275,000. Approximately $100,000 of this cost was incurred as at December 31, 1998.

Outlook

Subsequent to December 31, 1998, Serval sold capital assets for gross proceeds of approximately $12.9 million. The capital assets sold were mainly assets used in Serval's discontinued Coronation-based pipeline construction business unit; 11 of 25 vacuum trucks used in Serval's continuing but downsized fluids management business; and redundant real estate located in Edmonton, Cold Lake and Estevan. The net proceeds from these sales will be used to reduce term debt and increase working capital.

On January 31, 1999, Serval closed a private placement of Special Notes. This provided incremental gross proceeds of $1.8 million, above the amount advanced at December 31, 1998 of $1.4 million.

Since December 31, 1998, Serval has made timely principal repayments of $2.2 million of its term debt. Management will seek to re-finance Serval's remaining term debt in order to more appropriately match it against Serval's long-term productive capacity and improve Serval's working capital position.

Serval will continue to rationalize its core business operations and reduce overhead. The discontinuances of its tubulars distribution and Coronation-based pipeline construction business unit subsequent to December 31, 1998 were part of this process.

The most significant upside rests with Serval's coiled tubing drilling initiative. Management expects that the coiled tubing drilling component of this initiative will become commercially viable in the spring/summer of 1999. The expected benefits from this investment have not yet commenced and there has been a delay of approximately eight months in the timing of this initiative. The main reasons for this are: the late delivery date of the first coiled tubing drilling rig from the manufacturer; technical problems experienced during its testing; weather conditions at the time of introduction; Serval's shortage of working capital; and market conditions that slowed customer demand for these services. However, Management believes this project is now ready and able to immediately provide significant cost saving benefits to Serval customers and in the process, enhance Serval's profitability.

Recent commodity price increases should strengthen investor confidence and lead to a greater flow of capital to Serval customers. This in turn is expected to increase demand for Serval products and services.

Management's Report

To the Unitholders of Serval Integrated Energy Services

The accompanying consolidated financial statements are the responsibility of Serval Management Inc. ("SMI" or "Management") as the Manager of Serval pursuant to the Administration Agreement and Management Agreement between Serval and SMI dated February 28, 1997.

Management is responsible for and has prepared and presented the consolidated financial statements in accordance with accounting principles generally accepted in Canada and has made any significant accounting judgements and estimates required, within acceptable levels of materiality. Management has ensured that financial information contained elsewhere in this Annual Report is consistent with the consolidated financial statements.

Management maintains systems of accounting and internal controls to provide: reasonable assurance that financial information is presented on a timely basis in a reliable, relevant and accurate manner; and transactions are properly authorized; and that assets are adequately safeguarded. At the annual meeting, unitholders appoint an independent firm of chartered accountants to audit the consolidated financial statements.

The trustees of Serval are responsible for reviewing and approving the consolidated financial statements and ensuring Management meets their financial reporting responsibilities. The consolidated financial statements which follow have been approved by the Trustees.

Jay C. Lyons
President and Chief Executive Officer

Allan H. Stevens, C.A.
Chief Financial Officer

Calgary, Alberta
May 20, 1999

Auditors' Report

To the Unitholders of Serval Integrated Energy Services

We have audited the consolidated balance sheets of Serval Integrated Energy Services ("Serval") as at December 31, 1998 and April 30, 1998 and the consolidated statements of loss and deficit and changes in financial position for the eight months ended December 31, 1998 and for the year ended April 30, 1998. These consolidated financial statements are the responsibility of Serval's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Serval as at December 31, 1998 and April 30, 1998, and the results of its operations and the changes in its financial position for the eight months ended December 31, 1998 and the year ended April 30, 1998 in accordance with generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Calgary, Alberta
May 7, 1999

Consolidated Balance Sheets

	December 31, 1998	April 30, 1998 (Restated Note 5)
ASSETS		
CURRENT		
Accounts receivable	**$ 22,237,108**	$ 26,567,829
Inventory	**12,296,769**	14,649,083
Prepaid expenses	**1,218,057**	1,203,418
Advances on equipment under construction (Note 17)	**2,481,668**	3,000,000
Net current assets of discontinued operations (Note 5)	**–**	1,946,718
	38,233,602	47,367,048
CAPITAL ASSETS (Notes 6 and 21)	**46,038,223**	42,817,458
GOODWILL (Notes 7, 15 and 21)	**8,248,214**	14,240,760
OTHER ASSETS (Notes 8 and 15)	**4,813,731**	3,150,319
NET OTHER ASSETS OF DISCONTINUED OPERATIONS (Note 5)	**796,722**	4,042,204
	$ 98,130,492	$ 111,617,789
LIABILITIES		
CURRENT		
Bank indebtedness (Note 9)	**$ 19,661,370**	$ 25,404,911
Accounts payable and accrued liabilities	**25,250,476**	16,350,218
Net current liabilities of discontinued operations (Note 5)	**516,171**	–
Current portion of long-term debt (Notes 10 and 21)	**6,908,967**	4,208,363
Term debt, otherwise long-term (Notes 10 and 21)	**16,230,878**	–
	68,567,862	45,963,492
LONG-TERM DEBT (Notes 10 and 21)	**1,655,726**	8,470,444
DEFERRED INCOME TAXES	**–**	2,498,352
SUBSCRIPTION PROCEEDS FOR SPECIAL NOTES (Note 12)	**1,439,335**	–
	71,662,923	56,932,288
UNITHOLDERS' EQUITY		
Authorized - unlimited number without nominal or par value		
Issued – 4,778,160 units (Note 11)	**51,388,442**	51,422,858
Contributed surplus (Note 11)	**434,882**	418,320
(Deficit) retained earnings	**(25,355,755)**	2,844,323
	26,467,569	54,685,501
	$ 98,130,492	$ 111,617,789

APPROVED BY THE TRUSTEES

J.V. Lyons

J.V. Lyons, Trustee

Jay C. Lyons, Trustee

Consolidated Statements of Loss & Deficit

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998 (Restated Note 5)
REVENUE	$ 57,205,987	$ 148,908,542
OPERATING COSTS	48,713,902	120,992,071
	8,492,085	27,916,471
EXPENSES		
General and administration	13,572,042	17,781,076
Depreciation and amortization	4,378,970	6,321,279
Interest and other	2,241,243	786,214
Loss (gain) on sale of capital assets	472,351	(987,414)
	20,664,606	23,901,155
	(12,172,521)	4,015,316
RESTRUCTURING EXPENSES (Note 15)	(1,869,782)	–
WRITE-DOWN OF INVENTORY (Note 15)	(925,000)	–
WRITE-DOWN OF GOODWILL AND OTHER ASSETS (Note 15)	(12,270,868)	–
(LOSS) EARNINGS BEFORE INCOME TAXES	(27,238,171)	4,015,316
(INCOME TAXES) RECOVERY (Note 14)		
Current – large corporations tax	(195,131)	(135,630)
Deferred	2,379,652	(1,028,000)
	2,184,521	(1,163,630)
(LOSS) EARNINGS FROM CONTINUING OPERATIONS	(25,053,650)	2,851,686
(LOSS) FROM DISCONTINUED OPERATIONS (Note 5)	(3,146,428)	(7,363)
NET (LOSS) EARNINGS	(28,200,078)	2,844,323
RETAINED EARNINGS, BEGINNING OF PERIOD	2,844,323	–
(DEFICIT) RETAINED EARNINGS, END OF PERIOD	$ (25,355,755)	$ 2,844,323
NET (LOSS) EARNINGS PER UNIT (Note 11)		
Basic		
Continuing operations	$ (5.24)	$ 0.62
Discontinued operations	(0.66)	0.00
	$ (5.90)	$ 0.62
Fully diluted		
Continuing operations	$ (5.24)	$ 0.61
Discontinued operations	(0.66)	0.00
	$ (5.90)	$ 0.61

Consolidated Statements of Changes In Financial Position

		Eight Months Ended December 31, 1998		Year Ended April 30, 1998
				(Restated Note 5)
NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES				
OPERATING				
Net (loss) earnings from continuing operations	$	**(25,053,650)**	$	2,851,686
Items not affecting cash				
Deferred income taxes		**(2,379,652)**		1,028,000
Write-down of goodwill and other assets (Notes 15 and 21)		**12,270,868**		–
Loss (gain) on sale of capital assets		**472,351**		(987,414)
Depreciation and amortization		**4,378,970**		6,321,279
Other		**726,488**		(63,795)
Funds (applied to) provided from continuing operations		**(9,584,625)**		9,149,756
Funds (applied to) provided from discontinued operations		**(1,800,280)**		363,617
		(11,384,905)		9,513,373
Changes in non-cash operating working capital (Note 13)				
Related to continuing operations		**17,794,573**		(13,334,659)
Related to discontinued operations		**2,248,688**		(1,168,984)
		20,043,261		(14,503,643)
		8,658,356		(4,990,270)
INVESTING				
Acquisition of businesses (Note 4)		**(5,026,511)**		(50,585,751)
Acquisition of capital assets		**(9,646,261)**		(28,535,739)
Proceeds on disposal of capital assets		**2,497,798**		5,297,636
Acquisition of other assets		**(7,214,840)**		(2,469,032)
Proceeds on sale of (investments in) discontinued operations		**3,000,000**		(1,493,583)
		(16,389,814)		(77,786,469)
FINANCING				
Issue of units (Note 11)		**–**		53,151,748
Repurchase and redemption of units (Note 11)		**(17,854)**		(1,310,570)
Subscription proceeds for special notes (Note 12)		**1,439,335**		–
Proceeds from long-term debt		**26,227,880**		13,240,926
Repayment of long-term debt		**(14,111,115)**		(7,678,473)
Net repayment of long-term debt in discontinued operations		**(63,247)**		(31,903)
		13,474,999		57,371,728
NET CASH INFLOW (OUTFLOW)		**5,743,541**		(25,405,011)
(BANK INDEBTEDNESS) CASH, BEGINNING OF PERIOD		**(25,404,911)**		100
BANK INDEBTEDNESS, END OF PERIOD	$	**(19,661,370)**	$	(25,404,911)
CASH FLOW (OUTFLOW) PER UNIT (Note 11)				
Basic				
Continuing operations	$	**(2.01)**	$	2.00
Discontinued operations		**(0.37)**		.08
	$	**(2.38)**	$	2.08
Fully diluted				
Continuing operations	$	**(2.01)**	$	1.90
Discontinued operations		**(0.37)**		.07
	$	**(2.38)**	$	1.97

Notes to the Consolidated Financial Statements

Period Ended December 31, 1998

1. NATURE AND COMMENCEMENT OF BUSINESS

Serval Integrated Energy Services ("Serval") is an unincorporated trust established under the laws of the Province of Alberta, pursuant to a Declaration of Trust, dated February 28, 1997. On June 15, 1998, it changed its name from Serval Growth Fund to Serval Integrated Energy Services to more appropriately describe the nature of its operations. On December 31, 1998, it changed its fiscal year end from April 30 to December 31 to be consistent with the majority of its industry participants.

Serval was created to acquire 100% of the issued and outstanding common shares of Serval Corporation ("the Corporation") and $10 million of 2% unsecured subordinated notes ("Notes") of the Corporation from Lynx Energy Services Corp. ("Lynx"). This acquisition became effective on May 5, 1997 when Serval issued 3,278,069 Units and 3,278,069 Rights to acquire an additional 1,092,689 Units to Lynx. These Units and Rights were distributed by Lynx to its shareholders by a dividend-in-specie in May, 1997. Subsequently, Serval acquired an additional $11,648,819 of Notes of the Corporation.

The consolidated financial statements include the results of operations from May 5, 1997, the effective date of acquisition of the Corporation by Serval.

Prior to the acquisition of the Corporation, the balance sheet of Serval was comprised of cash of $100 and unitholders' equity of $100; Serval had no prior operations.

Administrative services are provided to Serval by Serval Management Inc. ("SMI") pursuant to an Administration Agreement (the "Administration Agreement") dated February 28, 1997. SMI is owned by the President and Chief Executive Officer of Serval, who is also a Trustee. The Corporation is managed by SMI pursuant to a separate Management Agreement (the "Management Agreement") dated February 28, 1997.

No distribution of income or capital by Serval is currently anticipated as cash flow will be reinvested.

2. BASIS OF PRESENTATION

Serval's consolidated financial statements have been presented on a going concern basis, which assumes that Serval will be able to realize its assets and discharge its liabilities in the normal course of business. Serval has a negative working capital position and current operations have resulted in negative cash flow. In addition, Serval is not in compliance with its loan covenants (Note 10). The continuing operations of Serval may be dependent upon some or all of the following factors:

- the ability of Serval to obtain further debt or equity financing
- improvement in operations
- the continued support of the lenders
- the completion of certain sales of assets

If the going concern assumption were not appropriate for these consolidated financial statements, then adjustments may be necessary to the carrying value of assets and liabilities, the reported net loss and the balance sheet classifications used.

Subsequent to December 31, 1998, Serval's operations were reduced through the discontinuance of its tubular operations and its Coronation, Alberta-based pipelining operations. Redundant assets have been sold and additional capital injected to reduce debt and improve Serval's financial position (Notes 12 and 21).

3. SIGNIFICANT ACCOUNTING POLICIES

Consolidation

The consolidated financial statements of Serval include the accounts of Serval and its subsidiary companies, all of which are wholly-owned. These consolidated financial statements comply in all material respects with Canadian generally accepted accounting principles.

Inventory

Inventory consists mainly of materials held for resale, valued at the lower of cost and net realizable value.

Capital assets

Capital assets are recorded at cost and depreciated on a straight-line basis over their estimated useful lives, net of estimated residual values as follows:

Buildings	20 years
Manufacturing equipment	5 to 10 years
Field equipment	5 to 10 years
Automotive equipment	2 to 5 years
Office furniture and equipment	2 to 5 years
Leasehold improvement	Term of the lease

Goodwill

Goodwill represents the excess of cost over the amount allocated to the assets acquired in business acquisition transactions. Goodwill is recorded at cost less accumulated amortization. Amortization is provided on a straight-line basis over 20 years. The recoverability of goodwill is periodically assessed and any permanent impairment in value is written off against earnings.

Deferred development costs

Included in other assets are costs relating to the acquisition of rights to certain technology and its subsequent development. These are amortized on a straight-line basis over five years, commencing upon commercial application. When the ultimate recovery is determined to be uncertain, such costs are charged to earnings.

Foreign currency translation

Serval follows the temporal method for translating foreign currency transactions and the financial statements of foreign subsidiaries. Under this method:

i) monetary assets and liabilities are translated at the rates of exchange prevailing at the balance sheet date;

ii) non-monetary items are translated at historic exchange rates; and

iii) revenue and expenses (other than depreciation and amortization) are translated at average rates of exchange during the year.

The resulting gains or losses are included in earnings.

Financial instruments

The carrying value of cash, accounts receivable, advances on equipment under construction, accounts payable, subscription proceeds for Special Notes, accrued liabilities and similar assets and liabilities of a financial nature approximate fair values based on the short-term maturity of these instruments. Interest rates on long-term debt are either at floating interest rates or at approximate current market rates. Therefore fair value of long-term debt approximates its carrying value.

4. BUSINESS ACQUISITIONS

All acquisitions are accounted for using the purchase method. Accordingly, the results of operations are included in Serval's operating results from the date of acquisition.

a) In the period ended December 31, 1998, Serval completed the following acquisition: Effective May 1, 1998, Serval acquired all of the outstanding shares of Bearspaw Compression Industries Ltd. ("Bearspaw") in exchange for cash consideration of $4,359,050 and the assumption of bank indebtedness of $667,461. The net assets acquired included:

Non-cash working capital	$	1,980,766
Capital assets		359,084
		2,339,850
Goodwill		2,686,661
Net assets acquired	$	5,026,511

b) In the year ended April 30, 1998, Serval completed the following acquisitions:

i) Effective May 5, 1997, Serval acquired all of the outstanding common shares of Serval Corporation and $10,000,000 of unsecured subordinated 2% Notes of the Corporation from Lynx Energy Services Corp. for consideration consisting of 3,278,069 Units of Serval and 3,278,069 Rights to acquire an additional 1,092,689 Units of Serval. The assets of the Corporation included cash of $8,014,038. The Corporation provides integrated energy services to oil and gas producers. This acquisition has been accounted for at the carrying value of such investments on the records of Lynx.

ii) Effective May 5, 1997, Serval acquired Wells-Hall Fabrication & Construction Ltd. ("Wells-Hall"), a manufacturer of oil and gas production equipment, for cash consideration of $4,753,594 and the assumption of $321,509 of bank indebtedness.

iii) Effective May 5, 1997, Serval acquired FPS Fiberglass Pipe and Supply Inc. ("FPS"), a distributor of fiberglass pipe, tubing, casing and related products for notes payable of $3,300,000 and the assumption of $1,934,410 of bank indebtedness. The notes payable were repaid prior to April 30, 1998.

iv) Effective May 5, 1997, Serval acquired Taylor Tubulars Ltd. ("Taylor"), a distributor of steel tubular products for notes payable of $3,444,621, and the assumption of $2,172,429 of bank indebtedness. The notes were repaid prior to April 30, 1998.

v) Serval acquired two other Canadian private corporations for aggregate cash consideration of $610,000, notes payable of $550,000 and the assumption of $10,297 of bank indebtedness.

4. BUSINESS ACQUISITIONS (cont'd)

The following is a summary of the purchase transactions during the year ended April 30, 1998:

	Corporation	Wells-Hall	FPS	Taylor	Other	Total
Non-cash working capital	$ 6,434,371	$ 872,031	$ 2,749,482	$ 2,623,634	$ 461,558	$ 13,141,076
Capital assets	23,603,423	2,008,553	12,544	59,365	54,954	25,738,839
Other assets	853,851	–	–	–	–	853,851
Long-term debt	(4,014,679)	–	–	–	(17,751)	(4,032,430)
Deferred income taxes	(1,470,352)	–	–	–	–	(1,470,352)
	25,406,614	2,880,584	2,762,026	2,682,999	498,761	34,230,984
Goodwill	8,082,277	2,194,519	2,472,384	2,934,051	671,536	16,354,767
Net assets acquired	$ 33,488,891	$ 5,075,103	$ 5,234,410	$ 5,617,050	$ 1,170,297	$ 50,585,751
Consideration:						
Units and Rights	$ 41,502,929	$ –	$ –	$ –	$ –	$ 41,502,929
Cash	–	4,753,594	–	–	610,000	5,363,594
Notes payable	–	–	3,300,000	3,444,621	550,000	7,294,621
(Cash acquired) Bank indebtedness assumed	(8,014,038)	321,509	1,934,410	2,172,429	10,297	(3,575,393)
Net cost	$ 33,488,891	$ 5,075,103	$ 5,234,410	$ 5,617,050	$ 1,170,297	$ 50,585,751

5. DISCONTINUED OPERATIONS

Effective October 31, 1998, Serval sold its bottled water business for cash proceeds of $3,000,000 and also discontinued its international operations which resulted in losses of $581,555 and $2,564,873, respectively. The following summary presents the financial position and results of operations of discontinued operations including the foregoing losses:

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
Results of operations		
Revenue	**$ 3,924,728**	$ 7,797,778
Expenses		
Operating	**3,005,351**	4,603,675
General and administrative	**1,550,733**	2,868,923
Depreciation and amortization	**236,246**	340,827
Interest and other	**422,231**	(20,894)
Loss on sale of fixed assets	**680,593**	310
Write-down of inventory and other assets	**524,220**	–
Closure costs	**607,500**	–
	7,026,874	7,792,841
(Loss) earnings before income taxes	**(3,102,146)**	4,937
(Income taxes) recovery		
Current	**(162,982)**	(12,300)
Deferred	**118,700**	–
	(44,282)	(12,300)
Net loss for the period	**$ (3,146,428)**	$ (7,363)

Notes to the Consolidated Financial Statements

Period Ended December 31, 1998

5. DISCONTINUED OPERATIONS (cont'd)

	December 31, 1998	April 30, 1998
Financial position		
Current assets	$ **1,087,275**	$ 2,521,038
Current liabilities	**(1,603,446)**	(574,320)
Net current (liabilities) assets	**(516,171)**	1,946,718
Capital assets	**796,722**	2,535,188
Goodwill	–	1,233,276
Other assets	–	342,982
Long-term debt	–	(69,242)
Net other assets	**796,722**	4,042,204
Net assets of discontinued operations	$ **280,551**	$ 5,988,922

6. CAPITAL ASSETS

	December 31, 1998		
	Cost	Accumulated Depreciation & Amortization	Net Book Value
Land	$ 2,538,016	$ –	$ **2,538,016**
Buildings	6,772,199	237,448	**6,534,751**
Manufacturing equipment	636,659	131,630	**505,029**
Field equipment	28,373,389	4,529,265	**23,844,124**
Automotive equipment	10,108,910	1,012,703	**9,096,207**
Furniture and office equipment	3,897,276	1,035,158	**2,862,118**
Leasehold improvements	789,311	131,333	**657,978**
	$ 53,115,760	$ 7,077,537	$ **46,038,223**

	April 30, 1998		
	Cost	Accumulated Depreciation & Amortization	Net Book Value
Land	$ 1,167,613	$ –	$ 1,167,613
Buildings	5,356,842	39,507	5,317,335
Manufacturing equipment	491,578	10,163	481,415
Field equipment	26,996,478	2,931,461	24,065,017
Automotive equipment	9,119,270	420,385	8,698,885
Furniture and office equipment	3,155,720	510,221	2,645,499
Leasehold improvements	482,469	40,775	441,694
	$ 46,769,970	$ 3,952,512	$ 42,817,458

7. GOODWILL

	December 31, 1998	April 30, 1998
Cost	$ **17,639,721**	$ 14,728,460
Accumulated amortization	**(1,052,239)**	(487,700)
Write-down (Note 15)	**(8,339,268)**	–
	$ **8,248,214**	$ 14,240,760

8. OTHER ASSETS

	December 31, 1998	April 30, 1998
Security deposit	$ **3,633,011**	$ –
Employee unit purchase plan (Note 11)	**109,080**	1,053,878
Refundable life insurance premiums	**473,802**	451,695
Notes receivable and deposits	**216,431**	261,266
	4,432,324	1,766,839
Deferred development costs	**4,020,743**	1,500,691
Less		
Accumulated amortization	**(842,476)**	(117,211)
Write-down of deferred development costs (Note 15)	**(2,796,860)**	–
Net deferred development costs	**381,407**	1,383,480
	$ **4,813,731**	$ 3,150,319

The security deposit of $3,611,011 is held by the lessor to secure Serval's obligations pursuant to an operating lease of equipment. The release to Serval of all or part of the deposit may be negotiated in future periods depending upon Serval's financial performance; or upon the replacement of the deposit with other security in form and substance satisfactory to the lessor; otherwise, the deposit and accrued interest thereon will be released to Serval on December 31, 2006, the termination date of the operating lease.

9. BANK INDEBTEDNESS

At December 31, 1998, Serval's operating line of credit was $25,000,000 (see Note 10). Borrowings under the operating facility may be made by way of prime rate based loans, bankers' acceptances, letters of credit or stand-by letters of guarantee. Borrowings are due on demand, bear interest at the bank's prime interest rate plus 0.5% or at market rates plus a 1.5% stamping fee. The operating facility is secured by specific assignments of accounts receivable and inventory and also by a general security agreement covering all the assets of Serval, on a parri passu basis along with Serval's major term lender.

10. LONG-TERM DEBT

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
Term debt bearing interest fixed at 7.7%, repayable in 41 equal monthly principal and interest instalments of $485,447 secured by a fixed charge over specific assets plus a general security agreement over all the assets on a parri passu basis with the operating facility lender	$ **17,451,566**	$ –
Capital loan bearing floating interest at bank prime plus 0.75% with monthly principal repayments of $70,000 secured by a fixed charge over specific assets plus a general security agreement over all the assets	**4,060,000**	–
Term debt bearing floating interest at bank's operational rate plus 0.5% with monthly principal repayments of $1,875 secured by a fixed charge over a specific asset	**225,000**	–
Note payable bearing floating interest at bank prime with principal repayments of $300,000 on February 28, 1999 and $250,000 on February 28, 2000 secured by letters of credit	**550,000**	550,000
Capital lease contracts and conditional sales contracts bearing interest at rates ranging from 2.9% to 7.8% secured by fixed charges on specific equipment with various monthly repayment terms	**2,509,005**	2,868,807
Bank loans bearing floating interest from prime to prime plus 0.5% secured by a general security agreement over all assets of Serval with monthly principal repayments of $170,000	**–**	9,260,000
	24,795,571	12,678,807
Less current portion	**(6,908,967)**	(4,208,363)
Less amount otherwise long-term reclassified current due to non-compliance with loan covenants	**(16,230,878)**	–
	$ **1,655,726**	$ 8,470,444

Had Serval been in compliance with its loan covenants, the amount of principal repayments otherwise due in the next five years would be:

1999	$ 6,829,784
2000	$ 6,861,605
2001	$ 6,615,722
2002	$ 3,492,540
2003	$ 783,420

At December 31, 1998, Serval was in technical breach of covenants under its loan agreements requiring a minimum working capital ratio of (1.1 to 1.0) and a maximum ratio of consolidated debt to tangible net worth (2.0 to 1.0). Serval's secured term lenders have not demanded repayment of Serval's term debt nor have they waived their right to do so. Accordingly, $16.2 million of term debt that would otherwise be classified as "long-term" has been reclassified as "current" in accordance with generally accepted accounting principles. All payments required under the term debt facilities have been paid when due and these facilities were otherwise in good standing at December 31, 1998.

Interest on long-term debt for the eight months ended December 31, 1998 amounted to $1,157,921 (year ended April 30, 1998 - $441,546).

11. CAPITAL

	Number of Units		Amount
Authorized			
Unlimited number of Units without nominal or par value			
Issued			
Original settlement, February 28, 1997	1	$	**100**
Issued to acquire the Corporation, May 5, 1997	3,278,069		**41,502,829**
Rights offering, July 2, 1997	1,092,689		**7,648,823**
Private placement, July 25, 1997	571,428		**3,999,996**
	4,942,187		**53,151,748**
Cancelled pursuant to normal course issuer bid and redemptions	(160,827)		**(1,728,890)**
Balance, April 30, 1998	4,781,360		**51,422,858**
Cancelled pursuant to normal course issuer bid	(3,200)		**(34,416)**
Balance, December 31, 1998	4,778,160	$	**51,388,442**

i) Contributed surplus

Contributed surplus of $434,882 (April 30, 1998 – $418,320) resulted from the difference between the book value of Units cancelled of $1,763,306 (April 30, 1998 – $1,728,890) and the actual cost of Units reacquired and redeemed of $1,328,424 (April 30, 1998 – $1,310,570).

ii) Unit Option Plan

There are 437,084 Units reserved for issuance pursuant to Serval's Unit Option Plan. Options may be granted to trustees of Serval or directors, senior officers, employees or consultants of Serval or SMI. The options vest equally over a four-year period from the date of grant and expire on the fifth anniversary date from the date of grant. At December 31, 1998, options to purchase 378,000 (April 30, 1998 – 303,000) Units were outstanding, having exercise prices ranging from $6.85 to $6.90 per Unit. At December 31, 1998, 161,500 options are exercisable.

	Number of Units
Options outstanding April 30, 1998	**303,000**
Options granted	**110,000**
Options cancelled	**(35,000)**
Options outstanding December 31, 1998	**378,000**

iii) Employee Unit Purchase Plan

During 1998, Serval established an Employee Unit Purchase Plan ("the Plan") under which eligible employees of the Corporation and its subsidiaries or SMI can purchase Units through payroll deductions. Initially, Serval will contribute one Unit for every three Units purchased by an employee on the market, subject to a one-year vesting period for Serval's contribution. At December 31, 1998, the Corporation had advanced $1,243,820 to the independent trustee for the purchase of 181,800 Units (April 30, 1998 – $1,053,878 for 143,200 Units) of Serval. Serval has written-down the carrying value of these Units by $1,134,740 to the current market value. The remaining amount of $109,080 is included in other assets (see Note 8) and will be charged to earnings in future periods based upon the Corporation's actual contribution requirements. All Units purchased by employees under the Plan will be purchased at fair market value.

11. CAPITAL (cont'd)

iv) Normal Course Issuer Bid

On November 13, 1997, Serval had a Normal Course Issuer Bid accepted by the Alberta Stock Exchange to repurchase up to 163,903 Units at market prices during the twelve-month period ending November 12, 1998. Under this bid, Serval repurchased 160,600 Units for a total cost of $1,309,100 to April 30, 1998 and an additional 3,200 Units for a total cost of $17,854 for the period ended December 31, 1998. The Units repurchased were cancelled.

Under the terms of a Normal Course Issuer Bid dated March 16, 1999, Serval may repurchase up to 93,467 Units at market prices in the one-year period ending March 16, 2000. A maximum of 2% of the outstanding Units may be repurchased in any 30 day period.

v) Redemptions

Under the provisions of the redemption right privileges available to holders of Units, there were no Units redeemed in the period ended December 31, 1998 (227 Units were redeemed at a total cost of $1,470 to April 30, 1998).

vi) Net earnings per unit and cash flow per unit

Net earnings per unit and cash flow per unit amounts have been calculated on the basis of the weighted average number of Units outstanding on December 31, 1998, which amounted to 4,779,255 (April 30, 1998 – 4,583,377). Fully diluted earnings per unit and fully diluted cash flow per unit amounts for the period ended December 31, 1998, have been calculated on the same basis as basic calculations as the fully diluted weighted average number of Units outstanding on December 31, 1998 of 5,157,255 (April 30, 1998 – 4,904,377) would have reduced the negative per Unit amounts for the current period.

12. SPECIAL NOTES

On January 31, 1999, Serval issued a private placement of 3,254.335 Special Notes bearing interest at 7.5% for total gross proceeds of $3,254,335 including the amount advanced at December 31, 1998 of $1,439,335.

The Special Notes are exerciseable into 3,254.335 unsecured subordinated redeemable Convertible Debentures of Serval at the earlier of (i) the third business day after the date of obtaining receipts for a final prospectus from the securities commissions in Ontario and Alberta to qualify the distribution of the Convertible Debentures to be distributed upon the exercise of the Special Notes; or (ii) February 5, 2000. In the event receipts for the final prospectus are not issued by June 30, 1999, the interest rate on the Special Notes will increase to 8% as will the interest rate on the Convertible Debentures when issued.

The Convertible Debentures are convertible at the option of the holders thereof into Units of Serval at an equivalent price of $3.25 per Unit (the "Conversion Price"). The maximum number of Units issuable upon the conversion of all Convertible Debentures is 1,001,334. The Convertible Debentures may be redeemed by Serval only after January 31, 2000 where appropriate notice is provided and the current market prices of the Units is greater than 150% of the Conversion Price.

13. CHANGES IN NON-CASH OPERATING WORKING CAPITAL

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
Continuing operations		
Accounts receivable	$ 6,118,141	$ 10,296,183
Inventory	4,137,610	(8,057,340)
Prepaid expenses	1,298	(677,156)
Advances on equipment under construction	518,332	(3,000,000)
Accounts payable and accrued liabilities	7,019,192	(11,896,346)
	$ 17,794,573	$ (13,334,659)
Discontinued operations		
Accounts receivable	$ 365,561	$ (278,088)
Inventory	759,481	(257,704)
Prepaid expenses	100,514	(73,133)
Accounts payable and accrued liabilities	1,023,132	(560,059)
	$ 2,248,688	$ (1,168,984)

14. INCOME TAXES

These consolidated financial statements include income taxes of Serval's operating subsidiaries.

Serval is subject to taxation on its income for the year, including taxable capital gains, less any portion that may be payable in the year to Unitholders which would be deducted by Serval in computing its taxable income.

The tax provision is based on rates applicable to each of the income tax jurisdictions in which Serval operates. The actual consolidated tax provision differs from that determined when the combined Canadian Federal and Provincial income tax rate is applied against the consolidated earnings before income taxes (the expected provision) for the following reasons:

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
Expected combined Canadian Federal and Provincial income tax rate	44.6%	44.6%
Expected provision for (recovery of) income taxes based on the above rate before discontinued operations	$ (12,148,224)	$ 1,719,634
Increases (decreases) in income taxes resulting from:		
Losses carried forward to future years	5,777,191	–
Non-deductible goodwill write-down	3,720,981	–
Non-deductible expenses	270,400	196,831
Use of previously unrecognized benefit of prior period losses of acquired companies	–	(888,465)
Federal large corporations tax – current	195,131	135,630
Actual income tax provision	$ (2,184,521)	$ 1,163,630
Consisting of:		
Current	$ 195,131	$ 135,630
Deferred (recovery)	(2,379,652)	1,028,000
	$ (2,184,521)	$ 1,163,630

15. RESTRUCTURING EXPENSES AND WRITE-DOWNS

Restructuring expenses

During the period ended December 31, 1998, Serval incurred restructuring costs of $1,869,782. This included costs to convert business units operating under predecessor names to Serval; severance costs; professional fees; relocation expenses; and accelerated write-offs relating to Serval's change in fiscal year end.

Write-down of inventory

Subsequent to December 31, 1998 (see Note 21), Serval discontinued its tubulars business. A reduction of $925,000 was recorded to adjust the carrying value of inventory to its estimated realizable value.

Write-down of goodwill

Subsequent to December 31, 1998 (see Note 21), Serval discontinued its pipelining business and also assessed the carrying value of other goodwill for impairment. As a result, the aggregate carrying value of goodwill was reduced by $8,339,268.

Write-down of other assets

As a result of an assessment of the commercial viability and future recoverability of deferred development costs and other assets, a write-down of other assets of $3,931,600 was recorded at December 31, 1998. This amount also includes the write-down of the carrying value of Serval units held for the Employee Unit Purchase Plan (see Note 11).

16. RELATED PARTY TRANSACTIONS

SMI is a private corporation controlled by the President and C.E.O of Serval.

SMI administers Serval and manages the Corporation pursuant to an Administration Agreement and a Management Agreement.

Under the terms of the Administration Agreement, SMI is entitled to an annual fee of $48,000. SMI is also entitled to a discretionary bonus determined by the Trustees and recovery of expenses.

Under the terms of the Management Agreement, SMI receives a base fee for providing the services of six employees and an incentive fee determined annually by the Trustees of Serval. SMI is also entitled to recovery of general and administration expenses, which amounted to $350,000 for the period ended December 31, 1998 and $916,500 for the year ended April 30, 1998.

The following is a summary of fees paid or payable to SMI in the period:

	Eight Months Ended December 31, 1998	Year Ended April 30, 1998
Administrative services fee	**$ 32,000**	$ 48,000
Management fees	**658,000**	552,000
Incentive compensation	**–**	275,490
	$ 690,000	$ 875,490

As at December 31, 1998 and April 30, 1998, there were no amounts payable to SMI by Serval.

17. COMMITMENTS

Minimum lease payments under operating leases for office premises, equipment and vehicles in each of the next five years amount to:

1999	$	**3,862,852**
2000	$	**3,344,003**
2001	$	**2,828,404**
2002	$	**2,922,534**
2003	$	**3,038,504**

Serval is committed to spend approximately $5,264,000 on capital assets in 1999, of which $2,481,668 has been placed on deposit with suppliers at December 31, 1998 (April 30, 1998 – $3,000,000).

18. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The "Year 2000 Issue" arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using the year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting Serval, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

19. CONTINGENCIES

i) A statement of claim has been filed against a subsidiary alleging $5.9 million in repair costs and lost profits from equipment sold to the Plaintiff. The Plaintiff purchased gas compression equipment from a predecessor company prior to the acquisition of that company by Serval. The equipment is alleged to have been defective although it is understood that the equipment presently operates in an acceptable manner. The claim also names the compressor manufacturer for misrepresentation and breach of warranties. Serval is advised that the terms and conditions of the contract with the Plaintiff constitute good defences at law. In addition, Serval is indemnified by the former owners of the subsidiary. Serval also believes that the alleged claim for lost production is without merit.

   Serval has filed a statement of defense and counterclaimed against the Plaintiff for unpaid accounts receivable of $468,384.

   No provision for settlement has been provided for in the consolidated financial statements. Although Serval considers its account receivable from the Plaintiff to be collectible, it has provided a full allowance for its doubtful collection in the financial statements.

ii) Three separate statements of claim have been filed against various Serval subsidiaries by former employees alleging wrongful dismissal. The aggregate amount of these claims is $795,708. Serval considers these claims to be without merit; accordingly no provision has been recorded in the consolidated financial statements.

19. CONTINGENCIES (cont'd)

iii) A former Officer and Director of Lynx Energy Services Corp. has filed a statement of claim of $286,000 against Serval as successor to Lynx alleging lost profits on sale of stock options. In September 1996, the Plaintiff took a severance package from Lynx including stock options which options were later disapproved by The Toronto Stock Exchange. The Plaintiff alleges misrepresentation and negligence of Lynx management in dealing with the Toronto Stock Exchange. Serval considers the claim to be without merit; accordingly no provision has been recorded in the consolidated financial statements.

iv) Two separate statements of claim have been filed against Serval in the aggregate amount of $869,000 for damages to equipment and costs incurred in fighting a wellsite fire in January 1997. No provision for this claim is included in the consolidated financial statements as these amounts are adequately covered by insurance in the event Serval is determined to be responsible for any of the alleged damages.

v) A number of claims have been filed against Serval alleging unpaid amounts in the aggregate of approximately $3.6 million. The consolidated financial statements contain adequate provision for these liabilities.

20. SEGMENTED INFORMATION

Continuing operations
Period Ended December 31, 1998:

	Waste Management	Manufactured Products	Coiled Tubing	Construction	Corporate	Total
Revenue	$ 8,608,809	$ 35,083,763	$ 310,245	$ 13,203,170	$ –	$ 57,205,987
Depreciation and amortization	$ 1,960,369	$ 759,178	$ 25,793	$ 1,273,812	$ 359,818	$ 4,378,970
Earnings (loss) from operations before the following:	$ (3,488,649)	$ (754,051)	$ (281,886)	$ (1,748,680)	$ (5,899,255)	$ (12,172,521)
Restructuring expenses	$ (261,135)	$ (603,962)	$ –	$ (264,177)	$ (740,508)	$ (1,869,782)
Write-down of inventory	$ –	$ (925,000)	$ –	$ –	$ –	$ (925,000)
Write-down of goodwill and other assets	$ (2,441,534)	$ (5,217,521)	$ (892,483)	$ (2,035,084)	$ (1,684,246)	$ (12,270,868)
Earnings (loss) from continuing operations before income taxes	$ (6,191,318)	$ (7,500,534)	$(1,174,369)	$ (4,047,941)	$ (8,324,009)	$ (27,238,171)
Cash flow (outflow) from continuing operations	$ (1,398,172)	$ (1,314,538)	$ (256,093)	$ (450,089)	$ (6,165,733)	$ (9,584,625)
EBITDA	$ (416,770)	$ 327,564	$ (165,354)	$ (71,126)	$ (4,754,271)	$ (5,079,957)
Total assets	$ 29,566,752	$ 35,794,350	$ 9,610,825	$ 17,966,826	$ 4,395,017	$ 97,333,770
Capital expenditures	$ 1,227,393	$ 3,188,891	$ 2,891,712	$ 1,208,322	$ 1,129,943	$ 9,646,261

Continuing operations
Period Ended April 30, 1998:

	Waste Management	Manufactured Products	Coiled Tubing	Construction	Corporate	Total
Revenue	$ 28,745,210	$ 79,563,197	$ –	$ 40,600,135	$ –	$ 148,908,542
Depreciation and amortization	$ 2,264,774	$ 676,764	$ –	$ 2,976,332	$ 403,409	$ 6,321,279
Earnings (loss) from continuing operations before income taxes	$ 1,220,919	$ 2,320,156	$ –	$ 3,774,900	$ (3,300,659)	$ 4,015,316
Cash flow (outflow) from continuing operations	$ 3,599,227	$ 2,977,363	$ –	$ 6,189,935	$ (3,616,769)	$ 9,149,756
EBITDA	$ 4,749,166	$ 3,204,833	$ –	$ 6,668,407	$ (4,487,011)	$ 10,135,395
Total assets	$ 33,581,683	$ 36,941,059	$ –	$ 21,275,560	$ 13,830,565	$ 105,628,867
Capital expenditures	$ 14,916,897	$ 1,205,410	$ –	$ 8,364,169	$ 4,049,263	$ 28,535,739

Geographically, all of Serval's continuing operations are conducted in Canada (see Note 5).

21. SUBSEQUENT EVENTS

On March 1, 1999, Serval discontinued its tubulars distribution business. A write-down of $925,000 (see Note 15) was recorded at December 31, 1998 to adjust the carrying value of tubulars inventory to its estimated realizable value.

On April 1, 1999, Serval also discontinued its Coronation, Alberta-based pipelining component of its construction division.

At December 31, 1998, a write-down of goodwill and other assets of $8,339,268 (see Note 15) was recorded in recognition of the impairment of the carrying value of those assets relating to the discontinued tubulars and Coronation-based pipelining businesses.

Since December 31, 1998, Serval sold capital assets for gross proceeds of approximately $12.9 million. The capital assets sold were mainly comprised of: pipelining equipment; 11 of Serval's 25 vacuum trucks; and redundant real estate located in Edmonton, Cold Lake and Estevan. The net proceeds from dispositions will be used to reduce term debt and other liabilities.

The following amounts for the tubulars and Coronation-based pipelining businesses were included in the financial statements as continuing operations (see Note 20) at December 31, 1998:

	Tubulars	Coronation Pipelining	Total
For the period ended December 31, 1998:			
Revenue	$ 16,733,273	$ 13,203,170	$ 29,936,443
Depreciation and amortization	$ 196,632	$ 1,273,812	$ 1,470,444
Loss from operations before the following:	$ (980,054)	$ (1,748,680)	$ (2,728,734)
Restructuring expenses	$ –	$ (264,177)	$ (264,177)
Write-down of inventory	$ (925,000)	$ –	$ (925,000)
Write-down of goodwill and other assets	$ (5,145,801)	$ (2,035,084)	$ (7,180,885)
Loss before taxes	$ (7,050,855)	$ (4,047,941)	$(11,098,796)
Cash outflow to operations	$ (1,708,422)	$ (450,089)	$ (2,158,511)
EBITDA	$ (579,582)	$ (71,126)	$ (650,708)
For the Period Ended April 30, 1998:			
Revenue	$ 60,117,465	$ 40,600,135	$ 100,717,600
Depreciation and amortization	$ 294,447	$ 2,976,332	$ 3,270,779
Earnings from operations before taxes	$ 1,025,664	$ 3,774,900	$ 4,800,564
Cash flow from operations	$ 1,320,526	$ 6,189,935	$ 7,510,461
EBITDA	$ 1,531,940	$ 6,668,407	$ 8,200,347

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